



**CITY OF SCOTTSDALE
AUDIT COMMITTEE
Attorney Conference Room
3939 N. Drinkwater Blvd
Scottsdale, AZ 85251
NOVEMBER 20, 2006**

PRESENT: Jim Lane, Committee Member
Wayne Ecton, Committee Member

ABSENT: Ron McCullagh, Committee Member

STAFF: Cheryl Dreska, City Auditor
Kyla Anderson, Audit Associate
Joyce Gilbride, Assistant City Auditor
Lisa Gurtler, Assistant City Auditor
Richard Chess, Accounting & Tax Audit Director
Scott McCarty, Financial Services Assistant GM
Paula Novacek, Accounting Manager

OTHER: Sandy Cronstrom, Cronstrom, Osuch & Co.
Carter Smitherman, Cronstrom, Osuch & Co.

CALL TO ORDER/ROLL CALL

Chairman Lane called the Audit Committee meeting to order at 2:02 p.m. Roll call was taken confirming the presence of Chairman Lane and Committee Member Ecton.

MINUTES - Approval of Nov 8, 2007 Committee Meeting Minutes

Committee Member Ecton made a motion to approve the November 8, 2007, minutes. Chairman Lane seconded the motion. The minutes were approved by a unanimous vote of two (2) to zero (0).

GENERAL BUSINESS

Agenda Item 1 Presentation from the City's external auditors on the results of the annual audit, potential discussion on the 2007 Comprehensive Annual Financial Report, Management Letter and Single Audit Report.

Mr. Carter Smitherman from Cronstrom, Osuch & Co. gave an overview of the three sections of the Comprehensive Annual Financial Report, indicating the report is comprised of three sections: Introductory, Financial and Statistical.

Mr. Smitherman stated the Introductory Section contains a letter of transmittal written by City management introducing readers to the City. It also includes elected and principal officials of the City, a City organizational chart, and the Government Finance Officers' Association Certificate for Financial Reporting.

Mr. Smitherman said the Financial Section includes the Independent Auditor's Report giving unqualified opinions on the financial statements. Management's Discussion and Analysis is a letter prepared by management presenting current year financial activity, presenting explanations and analysis for any changes. The Basic Financial Statements and notes contain all financial activity and related disclosures for the City for the fiscal year. Combining and Individual Statements provide more detail of the Basic Financial Statements.

Mr. Smitherman stated the Statistical Section presents various financial, demographic, and operational data for the City on a multi-year basis. This information can assist readers in interpreting historic financial and economic trends.

Chairman Lane asked for clarification on the Statistical Section data, specifically the historical measurement of government activities and expenses, including net assets by component. Mr. Smitherman stated the net assets component is compiled via the full accrual method of accounting, and are broken down into government and business sections, which are subcategorized. Net assets include items like capital assets and long-term debt. Fund balance information can be found on Page 127.

Chairman Lane asked if there was a summary of the entries that translate one to the other. Mr. Smitherman indicated the reconciliation can be found on Pages 32 and 35 in the Basic Financial Statements. Page 32 reconciles the balance sheet of governmental funds to the statement of net assets, and Page 35 reconciles the statement of revenues and expenditures and changes of fund balance to the statement of activities. More details are provided in the notes beginning on Page 52.

Referencing the Report on Internal Control Over Financial Reporting and Compliance, Chairman Lane asked for clarification on the language in Paragraph 3. Mr. Smitherman stated the report has been reformatted and there has been a change in the auditing standards. A control deficiency is a situation where either internal controls are not functioning properly or the control is not being performed effectively. Chairman Lane expressed concern regarding the language, "will not be prevented or detected by the City of Scottsdale's Audit Arizona Internal Control". Mr. Smitherman stated that would be in the event of a significant deficiency where an error occurs in the financial statement process without being detected. Although no significant deficiencies were found with the City, new audit standards require definition. Chairman Lane clarified that

the definition is stating the internal controls of the City of Scottsdale would not detect or prevent a significant deficiency. Mr. Smitherman disagreed, stating it is simply defining what a significant deficiency is. The phrase "will not be prevented or detected" is part of the definition. Chairman Lane stated the language leaves a question, especially in view of the fact there is no testing and no opinion on internal control.

Chairman Lane asked if there was a test of internal control performed. Mr. Smitherman stated some testing was performed as part of the audit; however, an opinion is not given based on the fact it is sample testing. These tests are used to design audit test work in other areas, not to give an opinion on internal controls.

Committee Member Ecton clarified that an audit of the internal controls is performed by the internal auditors. City Auditor Cheryl Dreska stated that is true, but it is not a comprehensive audit, it is only performed in the areas that are being audited at any particular point in time. Chairman Lane asked if there is a consultation or an interface that would affirm or deny internal controls operating as they should or that they are in place. Ms. Dreska indicated the City Auditor's Office provide copies of all of their reports to the external auditors. In addition, the City has contacted them to review their work papers as a way of limiting the amount of testing necessary by the internal auditors.

Mr. Smitherman stated any governmental or non-profit organization that expends over \$500,000 of federal monies is required to undergo a Single Audit. Major programs were selected based on federal guidelines, and Cronstrom, Osuch & Co. gave an unqualified opinion on the major programs that were audited. None of the findings were required to be reported. No material weaknesses, City deficiencies, or material noncompliance issues were identified.

Chairman Lane asked for clarification regarding the \$300,000 threshold to distinguish between Type A and Type B programs. Mr. Smitherman indicated that is a federal requirement; programs defined as a Type A (+\$300,000) must be assessed as high risk or low risk. He stated this requirement encourages auditors to rotate the programs audited each year.

Mr. Smitherman presented the Management Letter to the Committee, indicating this includes two minor operational findings that present management with opportunities to strengthen particular areas.

Mr. Smitherman stated the Court is currently in a situation where they have minimum accounting standards set by the Arizona Supreme Court that says if they issue a bond refund, it must be issued by check; however, they have a legal agreement with their merchants that requires them to refund bonds posted with a credit card back to that particular card. Chairman Lane indicated this issue was broached last year, and Mr. Smitherman stated the City has requested an exemption from the MAS related to that refund, and the Arizona Supreme Court is considering revising their minimum accounting standards to create an exemption in that particular area.

The second item addressed in the Management Letter has to do with home grants whereby reimbursement requests were not always submitted in a timely manner. Most grants are reimbursement grants, requiring the City to spend money first, and then go to the grantor to request the funds. During testing of the home grants there was an unreasonable amount of time between when the money was expended and when the

grant monies were applied for, creating a cash flow issue. Chairman Lane asked if there was an expiration or deadline to file for reimbursement. Mr. Smitherman stated there could be; however, it varies grant to grant. Committee Member Ecton asked what the normal allowable timeframe to apply for reimbursement is, and Mr. Smitherman stated it is usually monthly or quarterly. Accounting Manager Paula Novacek stated the City has an administrative regulation for grants, asking that they get reimbursed monthly or quarterly. Chairman Lane stated the ultimate exposure would be losing grant monies by waiting too long to file for reimbursement. Ms. Dreska stated a similar issue was brought up last year in regard to the Airport and Homeland Security grants, prompting Financial Services to step up monitoring and grant auditing.

Mr. Smitherman reviewed new auditing standards, indicating there is a new standard for the City's 2007-2008 audit. This standard will require the auditors to communicate with the Audit Committee and involve them more in the audit process. Auditors will be required to communicate their responsibilities under generally accepted auditing standards and give an overview of the plan, scope, and timing of the audit, along with any significant findings.

Generally accepted auditing standards will be communicated to the Committee in an engagement letter distributed in either April or May 2008. The engagement letter will outline the auditors' responsibilities. An overview of the plan, scope, and timing of the audit will be communicated through an entrance exam in May of 2008. Ms. Dreska stated this might require a review of the Audit Committee charter. Chairman Lane asked Ms. Dreska to prepare an agenda item for Council review, to include options for accommodating the new standard.

Mr. Smitherman stated although there have been none in the past, any significant findings would include qualitative aspects of significant accounting policies; significant difficulties encountered during the audit, and; uncorrected misstatements, other than those considered trivial. Chairman Lane asked if a test sample revealed some level of error, whether those findings would be extrapolated over the greater population. Mr. Smitherman indicated part of the new auditing standards require a projection of known or likely misstatements, and the effects of those uncorrected errors on the financial statements. Ms. Dreska stated the new standards require the potential risk associated with control breakdowns to be assessed. Mr. Smitherman indicated other significant findings could be disagreements with management to include accounting policies, estimates, and management's consultation with other accountants. Mr. Smitherman clarified that management's communication of any of this information to the Council does not relieve the auditor's responsibility of communicating that information.

Ms. Dreska stated she would like to agendize this discussion for a future meeting, along with discussion on the potential charter changes. She indicated that she would evaluate what the external auditors were proposing to ensure compliance with Yellow Book standards.

Ms. Novacek stated the 2008 Audit Contract will be on the December 11, 2007, City Council Consent Agenda.

PUBLIC COMMENTS

None.

COMMITTEE COMMENTS

Accounting and Tax Audit Director Richard Chess thanked the external auditors for a job well done.

ADJOURNMENT

With no further business to discuss, the Audit Committee meeting was adjourned at 2:36 p.m.

Submitted by

A/V Tronics, Inc.

Reviewed by

Cheryl Dreska
City Auditor